Business Combinations & Consolidations – Key Elimination Adjustments

1 Intercompany Receivables & Payables

- A company cannot owe itself—intercompany balances must be eliminated.
- Eliminating avoids overstated assets and liabilities ("grossed-up" balance sheet).
- Receivables = Payables → both sides must be removed.

2 Intercompany Inventory Sales

- Inventory is just relocated within the group—no external transaction.
- **Adjustments:**
  - Inventory must be reported at original cost to the group.
  - Write down inflated inventory values if profit was embedded.
  - Eliminate unrealized profit if inventory is unsold to third parties.
  - If sold externally, recognize profit = external sale price − original group cost.

3 Intercompany Fixed Asset Sales

- Treat asset as if it was never sold within the group.
- **Adjustments:**
  - Reset asset to original cost (pre-sale value).
  - Eliminate unrealized gain from seller's books.
  - Adjust buyer's depreciation to reflect original cost.
  - Correct accumulated depreciation as if no sale occurred.
  - Reduce seller's retained earnings to remove gain.

4 Other Intercompany Transactions

- Eliminate intercompany:
  - Bonds
  - Loans
  - Notes payable
  - Any similar internal financial instruments

5 Parent's Investment & Subsidiary's Equity

- Parent's "Investment in Subsidiary" is eliminated against subsidiary's equity.
- **Effects:**
  - Subsidiary's equity removed from consolidated balance sheet.
  - Only parent's declared dividends are reported.
  - Parent's share of subsidiary's net income is eliminated.
  - Subsidiary's full revenues and expenses appear in consolidated income statement.

6 Fair Value Adjustments (Tangible & Intangible Assets)

- Consolidation requires fair value remeasurement of subsidiary's assets.
- **Depreciation/Amortization Adjustments:**
  - ↑ Fair value → ↑ depreciation/amortization
  - ↓ Fair value → ↓ depreciation/amortization